Time to Shift into High Gear on Magna International Inc.?

Description

Canada's largest auto parts maker **Magna International Inc.** (TSX:MG)(NYSE:MGA) reported a 19% increase in its quarterly profit numbers on Thursday, reporting earnings per share (EPS) of $1.54, which beat market expectations of $1.34 EPS by $0.20. First-quarter revenue numbers also reached a record, increasing 5% to $9.37 billion to the delight of investors, who bid up the company's share price nearly 5% following the announcement.

With growing concerns surrounding increased protectionism in the U.S. market as well as a potential NAFTA renegotiation, investors have displayed caution with this name for some time. This positive earnings surprise, buoyed by strong demand and growing margins worldwide, has many analysts wondering what the future may hold for Magna moving forward and, specifically, if the steps the company has made of late are sustainable in the long term.

I'll dive into some of the specifics of the earnings release for long-term investors who are interested in how Magna has performed thus far this year, and how the company may be positioned for a continued rally.

Margin expansion solid

In Q1 2017, Magna's earnings and revenue growth were supported by solid reported margin expansion in most of its business segments; in particular, Magna's largest markets, the European market and the U.S. market, each saw EBIT margins expand by 50 basis points (bps) and 70 bps, respectively, from a year earlier.

A growing, yet small, market for the company is its Asian business segment; the company's Asian operations posted excellent margin growth with quarterly EBIT margins increasing 370 bps to 11.9%. This 11.9% margin is significant in that it represents the profitability of fastest-growing segment of Magna's business, more than doubling the EBIT margin of other regions the company operates in currently.

NAFTA renegotiation, border tax may be overblown

Analysts have pointed to the fact that while NAFTA appears to be on the table for renegotiation at this time, any significant changes to NAFTA with respect to the auto industry will likely be at least partially offset by the proposed U.S. corporate tax rate cut as well as the fact that large auto manufacturers with the scale of Magna typically have the ability to simply pass substantially all of the costs downstream; the consumer will ultimately pay the price of any border adjustment tax or version thereof.

A change to NAFTA that may make Canadian manufacturing more difficult or less profitable may ultimately mean that Magna will eventually shift production away from Canada accordingly over the long term — something that is not impossible for a manufacturer of Magna's size.

Bottom line

While I do believe that global auto trends are likely to shift significantly in the long term, and I personally do not want any exposure to the auto industry in this current economic environment. The short-term risks associated with the pending NAFTA negotiations, while very significant for Magna, represent only a portion of the company's global business portfolio.

The strong earnings may be just what the doctor ordered for investors looking for a reason to invest in Magna over the medium term; however, I would reference the current fundamentals of the auto market and lending market relating to the auto industry globally as one of the main reasons to be very cautious with respect to a long-term investment in a company like Magna at this time.

Stay Foolish, my friends.

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